

## I. Introduction

The Netherlands is an attractive and advantageous location for an (intermediate) holding, finance and licensing company to set up a strategic company structure for investments in the Republic of India (India) or the United States of America (United States). Primary benefits of a Dutch structure are the availability of the so-called Dutch participation exemption (no Dutch tax on qualifying dividends and capital gains), the absence of an interest and royalty withholding tax on ongoing interest and royalties, the favourable advance tax ruling system, the broad treaty network and the excellent and stable business climate.

This Tax Alert provides a brief overview of the advantages of structuring investments in and from both India and the United States via a holding company in the Netherlands.

## II. The Dutch corporate tax system

### 2.1. Dutch corporate income tax

Dutch resident companies (e.g. Dutch NV's, BV's and Cooperatives ("Coop's")) are in principle subject to Dutch corporate income tax ('CIT') on their worldwide income, at a rate of 20% for taxable profits up to EUR 200,000, and 25% on the excess, with the exception of certain statutory exemptions. Dutch branches are taxed on the income that is attributable to their Dutch operations (Dutch source income).

#### *Dutch Participation Exemption*

Under the Dutch participation exemption, dividends received from a qualifying subsidiary and capital gains realized on the disposition/sale of shares in such a subsidiary are exempt from Dutch corporate income tax. Below are the main conditions that must be met in order to qualify for the Dutch participation exemption:

- The Dutch parent company owns at least 5 percent of the nominal paid-up share capital of the subsidiary; and
- The subsidiary is not a so-called 'low taxed passive investment company'.

### 2.2. Dutch Holding Company

Most Dutch holding companies are private limited liability companies (BVs),

public limited liability companies (NVs) or Coop's.

**a) 'BV'**

As per October 1, 2012 new legislation concerning BV's has come into force. This legislation provides for an increased flexibility to set up a BV. For example, the minimum capital requirement of at least EUR 18.000 has been cancelled (and therefore a Dutch BV can be established with e.g. EUR 1 capital), transfer restrictions on shares have been abolished and multiple investor rights can be incorporated into the charter documents (articles of association).

**b) 'Coop'**

In the international structuring of group of companies, the Coop form is regularly used, e.g. as (intermediate) holding, finance and/or royalty flow-through company. From a Dutch CIT point of view the Coop is comparable to a BV or NV, with the major benefit of a Coop that in general it is not subject to Dutch dividend withholding tax.

**2.3. Functional currency**

In the Netherlands, corporate taxpayers can opt to file their Dutch CIT return in the functional currency of the group (e.g. the USD or the Indian Rupee) instead of the Euro.

**III. International Aspects**

**3.1. Worldwide tax treaty network**

The Netherlands has entered into many favourable tax treaties with countries worldwide, including with the Republic of India and The United States), which, among others, provide for substantial reduction of withholding tax ('WHT') on dividends, interest and royalties. Moreover, the Netherlands/Indian tax treaty provides for a so-called Tax Sparing Credit. This means that under circumstances, a Dutch entity is entitled to a credit for Indian WHT which is higher than the actual WHT paid in India (reference is made to e.g. paragraph 4.1.2. below).

In order to claim the benefits under the tax treaties concluded by the Netherlands, an entity should be considered a Dutch tax resident entity. This requires substance of such entity in the Netherlands. These substance requirements require - among other things - a minimum of 50% Dutch resident directors. The substance can e.g. be delivered by a trust company. A detailed description of such substance

requirements is available upon request.

### **3.2. Bilateral Investment Protection Treaties ('BIT')**

Separate from its tax treaty network, the Netherlands also has an extensive Bilateral Investment Treaty network (including with India, and with the US a so-called 'FCN Treaty', which is comparable to a BIT).

In general, such BIT protects investments made by e.g. Dutch resident investors into other countries with which the Netherlands has concluded a BIT. Also a shareholding in a company located in a country with which the Netherlands has concluded a BIT may qualify for that particular BIT protection. Most of the BITs concluded by the Netherlands include a so-called "national treatment"-clause and a "non-discrimination"-clause which in certain situations may also apply to taxes. In addition, these BIT's protect the investor from unfair expropriation by the other treaty country.

Since the Netherlands also has concluded a BIT with India, whilst the United States has not, investments by US investors in India via a Dutch intermediate holding will offer such US investors additional protection of their investments (and a national treatment in India. E.g., India shall accord to (equity) investments (including their operations, management, maintenance, use, enjoyment or disposal) made by a Dutch company, treatment which is not less favourable than that accorded either to investments of its own investors or to investors of any third State, whichever is more favourable to the Dutch investor.

When reviewing the information below, we note that both the US/Indian tax treaty and/or the US/NL tax treaty may apply. Both tax treaties provide for a so-called Limitation on Benefits Article. Taxpayers that want to claim benefits under one of these tax treaties should meet such limitation on benefits test. It falls beyond the scope of this Tax Alert to describe the features of the Limitation on Benefits articles.

For the purpose below, it is assumed that the relevant taxpayers can successfully claim such treaty benefits.

#### **4.1. US investors investing in India**

##### *4.1.1. A direct investment by US investors in India*

In such scenario, a US corporate investor invests directly in an Indian corporate

## **IV. Investment in India or the US via the Netherlands**

entity. Consequently, the US/Indian tax treaty may apply.

**Dividends:**

Under this US/Indian tax treaty, dividends received by an US corporate investor from its Indian investment, are subject to a maximum Indian dividend WHT tax of 15% if the US investor is the beneficial owner of the dividends, and owns at least 10% of the voting stock of the Indian company paying the dividends, and 25% in all other cases.

Under Indian domestic legislation, however, dividends paid by an Indian company are subject to a 15% Indian dividend distribution tax. If this tax is paid, no Indian dividend WHT is due upon a dividend distribution to foreign shareholders.

**Interest:**

If the Indian subsidiary is funded with US debt, interest payments by the Indian entity to its US creditor are subject to a Indian domestic interest WHT rate of 20% (and from 1 July 2012, any interest paid by an Indian company to a non-resident in respect of borrowings made in foreign currency from sources outside India between 1 July 2012 and 1 July 2015, under a loan agreement or an issue of long-term infrastructure bonds, is under circumstances taxable at the rate of 5%). Furthermore, the US/Indian tax treaty provides for a maximum interest WHT rate of 15% (and 10% if the interest is paid on a loan granted by a bank or financial institution).

**Royalties:**

Royalties paid by an Indian company to a US corporate entity are subject to an Indian domestic WHT rate of 10%. The US/Indian tax treaty provides for a maximum royalty WHT rate between 10% and 20%, dependent of the qualification of the royalty). Since the domestic rate is lower than the treaty rate, the domestic rate will apply.

**Capital gains:**

Under the US/Indian tax treaty, capital gains (e.g. realised upon the sale of shareholdings) may be taxed in accordance with the domestic Indian and US legislation. Under domestic Indian legislation, India has the right to tax a nonresident's Indian source income. Gains on the transfer of shares in an Indian company are considered to be Indian-source income.

Therefore, a US resident entity is subject to Indian tax on those capital gains.

Moreover, also the US may want to tax such capital gains based on their domestic legislation, which may lead to double taxation.

#### *4.1.2. An investment by US investors in India via a Dutch intermediate holdco*

In such scenario, a US corporate investor invests via a Dutch resident intermediate holding company in an Indian corporate entity. Consequently, the US/NL and the NL/Indian Indian tax treaty may apply.

#### **Most favoured nation clause and Tax Sparing Credit:**

As a preliminary remark, the NL/Indian tax treaty includes a so-called most favoured nation clause. This means that if a more beneficial tax provision concerning dividends, interest, royalties and fees for technical services or payments for the use of equipment will be included in a tax treaty between India and a third state (being an OECD member state), these beneficial provisions will apply in relation to the Netherlands as well. The US/Indian tax treaty does provide for such most favoured nation clause.

Furthermore, as said above, the NL/Indian tax treaty provides for a tax sparing credit, that may provide a Dutch entity with a tax credit that exceeds the actual WHT paid in India.

#### **Dividends:**

As said above, dividends paid by an Indian company are subject to a 15% Indian dividend distribution tax. If this tax is paid, no Indian dividend WHT is due upon a dividend distribution to foreign shareholders. Consequently, dividends paid by an Indian company to a Dutch corporate shareholder, are only subject to the 15% Indian dividend distribution tax (no further Indian dividend WHT is due upon a dividend distribution). Under certain circumstances (or if a Dutch COOP is used as intermediate holding company), no Dutch dividend WHT is due upon passing through such dividends to the US corporate shareholder.

Furthermore, please note that at the level of the Dutch entity, neither Dutch corporate income tax is due under the application of the Dutch participation exemption.

#### **Interest:**

As stated, the domestic Indian interest WHT rate is 20% (and any interest paid by an Indian company to a non-resident in respect of borrowings made in foreign currency from sources outside India between 1 July 2012 and 1 July 2015, under a loan agreement or an issue of long-term infrastructure bonds, is

under circumstances taxable at the rate of 5%).

If the Indian subsidiary is funded with debt, which debt is structured via the Dutch intermediate entity, the NL/Indian tax treaty reduces the Indian domestic interest WHT to 10% (which is based on the aforementioned 'most favoured nation clause' in this tax treaty (since rate of 10% does also apply under the newer tax treaty between India and Germany)).

A very interesting and advantageous tax planning idea may apply if the domestic Indian WHT rate would be reduced to less than 10% (e.g. for the abovementioned 5% Indian interest WHT rate): based on the so-called Tax Sparing Credit in the NL/Indian tax treaty, the Dutch recipient entity may nevertheless credit 10% Indian interest WHT even if the actual Indian WHT is less than 10% (e.g. in the abovementioned whereby the WHT rate is reduced to 5%)!

A further passing through of this interest by the Dutch entity to its US creditor (if applicable) is not subject to Dutch interest WHT, since the Netherlands' tax laws do not provide for a WHT on outgoing interest payments.

#### **Royalties:**

The domestic Indian royalty WHT rate is 10%. The NL/Indian tax treaty provides for a maximum royalty WHT of 10% as well (based on the most favoured nation clause in this tax treaty).

A further passing through of this royalty by the Dutch entity to its US licensor (if applicable) is not subject to Dutch royalty WHT, since the Netherlands' tax laws do not provide for a WHT on outgoing royalty payments.

#### **Capital gains:**

Under the NL/Indian tax treaty, capital gains (e.g. realised upon the sale of shareholdings) may normally be taxed in the Netherlands. As said, the Netherlands will not tax such capital gains under the application of the participation exemption.

A further distribution of such capital gains (by means of a dividend distribution) by the Dutch entity to its US corporate shareholder may under circumstances not be subject to Dutch dividend WHT.

## **4.2. Indian investors investing in the USA<sup>1</sup>**

### *4.2.1. A direct investment by Indian investors in the USA*

In such scenario, an Indian corporate investor invests directly in a US corporate

<sup>1</sup> Any description of tax matters herein, not relating to the Netherlands, should be independently verified and are reflected herein solely on the basis of our cursory understanding of such foreign tax laws.

entity. Consequently, the US/Indian tax treaty may apply.

**Dividends:**

The domestic US dividend WHT is 30%, which may be reduced under the US/Indian tax treaty. This treaty reduces the US dividend WHT to 15% if the beneficial owner is an Indian resident company which owns at least 10% of the voting stock of the US company paying the dividends, and 25% in all other cases.

**Interest:**

If the US subsidiary is funded with Indian debt, interest payments by the US entity to its Indian creditor are subject to a US domestic interest WHT rate of 30%. Under the application of the US/Indian tax treaty, the maximum interest WHT rate is 15% (and 10% if the interest is paid on a loan granted by a bank or financial institution).

**Royalties:**

Royalties paid by a US company to an Indian corporate entity are subject to a US domestic WHT rate of 30%. The US/Indian tax treaty provides for a maximum royalty WHT rate between 10% and 20%, dependent of the qualification of the royalty).

*4.2.2. An investment by Indian investors in the USA via a Dutch intermediate holdco*

**Dividends:**

As said, the domestic US dividend WHT rate is 30%. Under the application of the US/NL tax treaty, dividends distributed by a US company to its intermediate Dutch holding company are subject to a maximum US dividend WHT rate of 5% if the beneficial owner is a Dutch resident company which owns at least 10% of the voting stock of the US company paying the dividends, and 15% in all other cases. Even a withholding tax rate of 0% could apply (in very limited situations).

Furthermore, these dividends are not subject to corporate income tax in the Netherlands under the application of the participation exemption.

Upon a further passing through of these dividends by the Dutch intermediate holdco to its Indian corporate shareholder, in general Dutch dividend withholding tax is due at the domestic Dutch dividend WHT rate of 15%.

However, based on the NL/Indian tax treaty, this Dutch dividend WHT rate is reduced from 15% to 5% if the Indian shareholder owns at least 10% of the shares in the Dutch intermediate holdco. If the Indian shareholder owns less than 10% of the shares in the Dutch intermediate holdco, the NL/Indian tax treaty provides for a maximum Dutch dividend WHT rate of 10%. The aforementioned 5% and 10% Dutch dividend WHT can be further reduced with 3% (so only 2% respectively 7% Dutch dividend WHT due) to the extent a.o. the Dutch intermediate holdco owns at least 25% of the capital (or voting rights) in its US subsidiary (the so-called 'passing-through of dividends' facility in the Dutch domestic tax legislation).

If the Dutch intermediate holdco is structured as a Dutch resident COOP, no Dutch dividend WHT is due upon a dividend distribution to Indian, since a Dutch COOP may be exempt from Dutch dividend WHT. This is one of the reasons of the current popularity of using a Dutch COOP in international structuring.

**Interest:**

If the US subsidiary is funded with Dutch debt, interest payments by the US entity to its Dutch creditor are subject to a US domestic interest WHT rate of 30%. The US/NL tax treaty, however, determines that interest paid by a US company to its Dutch creditor is not subject to US interest WHT, provided the Dutch recipient of the interest is the beneficial owner of the interest. Therefore, normally no US interest WHT should be due upon interest payments to its Dutch creditor.

To the extent the Dutch entity is also funded with debt from its Indian shareholder, no Dutch interest WHT is due upon interest payments to India, since the Dutch tax laws do not provide for an interest WHT on outgoing interest payments.

**Royalties:**

The domestic US royalty WHT rate is 30%. The US/NL tax treaty, however, determines that royalties paid by a US company to its Dutch (sub) licensor is not subject to US royalty WHT, provided the Dutch recipient of the royalty is the beneficial owner of the royalty. Therefore, normally no US royalty WHT should be due upon royalty payments to its Dutch (sub)licensor.

A further passing through of this royalty by the Dutch entity to its Indian licensor (if applicable) is not subject to Dutch royalty WHT, since the Netherlands' tax laws do not provide for a WHT on outgoing royalty payments.

**Capital gains:**

Under the US/NL tax treaty, capital gains (e.g. realised upon the sale of shareholdings) may only be taxed in the Netherlands. As said, the Netherlands will not tax such capital gains under the application of the participation exemption.

A further distribution of such capital gains (by means of a dividend distribution) by the Dutch entity to its Indian corporate shareholder may under circumstances not be subject to Dutch dividend WHT.

**V. Conclusion**

Compared to a direct investment made by a US investor in India, the use of a Dutch intermediate holding company to invest in India, may provide a US corporate investor – besides the benefits under the Bilateral Investment Treaty between the Netherlands and India – with tax benefits. E.g. for funding structures benefits may be obtained based on the Tax Sparing Credit as applicable under the NL/Indian tax treaty, and moreover, taxation on capital gains realised upon the alienation of the shares in the Indian investment, may be reduced, postponed or even avoided.

In addition, compared to a direct investment made by an Indian investor in the USA, the use of a Dutch intermediate holding company to invest in the USA, may provide an Indian corporate investor – besides the benefits under the FCN Treaty between the Netherlands and the USA – with tax benefits. E.g. the WHT on dividends, interest and royalties may be reduced, and moreover, taxation on capital gains realised upon the alienation of the shares in the US investment, may be reduced, postponed or even avoided. However, as stated a Dutch intermediate holdco that holds a US investment should comply with the limitation on benefits article in the US/NL tax treaty.

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